

AGENDA – December 7, 1999 Business Taxes Committee Meeting
Application of Tax to Drop Shipments

Action 1 – Consent Staff and industry work together to develop administrative procedures to ensure that use tax is not collected from both the drop shipper and the California end user.	
Action 2 – Seek Legislation to Amend Section 6007 Amend the current drop ship provisions of Revenue and Taxation Code section 6007 to relieve the compliance difficulties facing California retailers who drop ship merchandise to consumers in California at the request of out-of-state retailers not engaged in business in California.	Approve either: 1) Staff’s proposal for legislation (Exhibit 1); or 2) One of the four industry proposals for legislation (Exhibit 1,)
Action 3 – Approve Submission of Proposal to the Legislative Committee (whichever proposal is approved)	

AGENDA – December 7, 1999 Business Taxes Committee Meeting
Application of Tax to Drop Shipments

ACTION 1 – Consent Item

Item	Comments
Staff and industry work together to develop administrative procedures to ensure that use tax is not collected from both the drop shipper and the California end user.	Staff and Industry agree that administrative procedures can be developed to prevent the double collection of tax on a drop shipment transaction.

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Application of Tax to Drop Shipments

Action Item	Staff Proposal	Industry Proposal
ACTION 2		
<p>“Apply Drop Shipment Rules Only to Drop Shipments from California”</p> <p style="text-align: center;">OR</p> <p>“Repeal the Drop Shipment Provisions of Section 6007 and Make All Drop Shipments Use Tax Transactions”</p> <p style="text-align: center;">OR</p> <p>“Relieve the Drop Shipper of Liability if They Accept a Resale Certificate from the True Retailer, Even if that Retailer is Not Engaged in Business in California”</p> <p style="text-align: center;">OR</p> <p>“Allow Drop Shipper to Avoid Reclassification as a Retailer of Drop Shipped Property by Issuing a Report to the Board Which Includes Relevant Information About the Transaction”</p> <p style="text-align: center;">OR</p>	<p>Seek legislation to amend section 6007 so that the drop shipment rules only apply to drop shipments from California, as was the case prior to the 1992 amendment to section 6007.</p> <p>Do not seek legislation.</p> <p>Do not seek legislation.</p> <p>Do not seek legislation.</p>	<p>Do not seek legislation.</p> <p>Seek legislation to amend section 6007 to repeal the drop shipment provisions and to make all such drop shipments subject to use tax whether shipped from California or from outside this state.</p> <p>Seek legislation to amend section 6007 so that drop shipper is not liable as the retailer if it accepts a resale certificate from the true retailer, even if that retailer is not engaged in business in California.</p> <p>Seek legislation to amend section 6007 to allow a drop shipper to avoid reclassification as a retailer of drop shipped property by issuing a report to the Board which includes the name and address of the California consumer along with a description of the property and the selling price the drop shipper charged the out-of-state retailer.</p>

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Application of Tax to Drop Shipments

Action Item	Staff Proposal	Industry Proposal
“Limit Drop Shipper’s Measure of Tax to the Amount They Charged Their Customer (the True Retailer) and Make all Such Drop Shipments Use Tax Transactions”	Do not seek legislation.	Seek legislation to amend section 6007 to limit the drop shipper’s measure of tax to the amount they charged the true retailer and to make all such drop shipments subject to use tax so that the California consumer is liable for tax on the entire transaction, but allowed credit for tax already paid by the drop shipper.

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Action Item	Staff Proposal	Industry Proposal
ACTION 3, Approve Submission of Proposal to the Legislative Committee (whichever proposal is approved)		

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Issue Paper Number **99-057**

12/7/99



BOARD OF EQUALIZATION
KEY AGENCY ISSUE

- ☐ Board Meeting
- ☒ Business Taxes Committee
- ☐ Customer Services Committee
- ☐ Legislative Committee
- ☐ Property Tax Committee
- ☐ Technology & Administration Committee
- ☐ Other

APPLICATION OF TAX TO DROP SHIPMENTS

I. Issue

How can the Board relieve the compliance difficulties facing California (and registered, out-of-state) retailers who drop ship merchandise to consumers in California at the request of out-of-state retailers not registered to collect California sales or use tax?

II. Staff Recommendation

Staff recommends the Board seek legislation to amend Revenue and Taxation Code section 6007 to limit the drop shipment rule to drop shipments made from California as was the case prior to the 1992 amendments of SB 1608. This action would eliminate the requirement that drop shippers engaged in business in California collect use tax on drop shipments shipped from outside California directly to California consumers pursuant to retail sales made by retailers not engaged in business in California. Staff further recommends that staff work together with industry to develop administrative procedures to minimize the possibility that sales or use tax is inadvertently collected from both the drop shipper and the California consumer on the same transaction.

III. Other Alternative(s) Considered

Alternative 1:

Seek legislation to repeal the drop shipment provisions of section 6007 and to make all such drop shipments subject to the use tax whether shipped from California or from outside this state.

Alternative 2:

Seek legislation to amend section 6007 so that a drop shipper is not liable as the retailer if it accepts a resale certificate from its customer (the true retailer), even if that customer (the true retailer) is not engaged in business in California.

Alternative 3:

Seek legislation to amend section 6007 to allow a drop shipper to elect to avoid reclassification as a retailer of drop shipped property by issuing a report to the Board which includes the name and address of the California purchaser/consumer along with a description of the property and the selling price the drop shipper charged the out-of-state retailer.

Alternative 4:

Seek legislation to amend section 6007 to limit the drop shipper's measure of tax to the amount they charged their customer (the true retailer) and to make all such drop shipments subject to use tax so that the California purchaser/consumer is liable for tax on the entire transaction, but allowed a credit for tax already paid by the drop shipper.

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IV. Background

In his letter of October 28, 1999, (Exhibit 2) Mr. Eric Miethke of Nielsen, Merksamer, Parrienello, Mueller & Naylor, LLP, discusses the difficulties faced by persons engaged in business in California in complying with the current statutory provisions governing the application of tax to transactions where the property is drop shipped by persons engaged in business in this state to California consumers pursuant to retail sales made by retailers who are not engaged in business in this state, and the options for legislative reform. These options include:

- Repeal the drop shipment rule and make the use tax applicable to all such sales.
- Amend section 6007 to allow a drop shipper to avoid being reclassified as the retailer by accepting a resale certificate from its customer (the true retailer), even though that retailer is not engaged in business in California.
- Amend section 6007 to allow a drop shipper to avoid liability as the retailer by making a timely election to make a report of relevant information to the Board.
- Amend section 6007 to limit the drop shipment rule to drop shipments made from California.

Staff met with Mr. Miethke on November 4, 1999, and discussed industry's concerns and suggested legislative reforms. Also discussed were industry's concerns regarding potential double taxation and administrative means to avoid it.

In his letter of November 15, 1999, (Exhibit 7) Mr. Douglas Boyd, Sr., from Moseley & Leech reiterates the burden the current drop shipment rules place on retailers engaged in business in California. Mr. Boyd also expresses his support of legislative reform that would allow drop shippers to accept resale certificates from retailers not engaged in business in California, as well as reform that would allow drop shippers to provide the Board with a report of relevant information instead of reporting tax on drop shipments.

Discussion of the Issue

Under existing law, sales tax is imposed on retailers for the privilege of selling tangible personal property at retail in California. When the sales tax does not apply, the use tax is imposed on the storage, use, or other consumption of tangible personal property purchased from a retailer. The sales tax is imposed on the retailer, and the use tax is imposed on the purchaser. However, under Revenue and Taxation Code section 6203, a retailer who is "engaged in business in this state" must collect the California use tax from the California consumer and remit that tax to the Board.

The sales tax was first adopted in California in 1933, and it applied only to sales in California. This meant that sales of tangible personal property shipped into California from outside the state were not subject to tax. After adoption of the sales tax, it was clear that this put California retailers at a disadvantage vis-à-vis their out-of-state competitors. In 1935, the Legislature therefore adopted the use tax to alleviate this disadvantage. Shortly thereafter, in 1939, the Legislature further refined the use tax provisions of the law by adopting the drop shipment rule, which is in Revenue and Taxation Code section 6007. This provided further protections for California retailers from tax advantages gained by out-of-state retailers who were not engaged in business in this state.

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Section 6007 defines “retail sale” to include transactions commonly known as “drop shipments” under specified circumstances. In general, drop shipment transactions involve two separate sales involving three persons: the consumer, the retailer (whom we will refer to as the “true retailer”), and the supplier or manufacturer (whom we will refer to as the “drop shipper”). The true retailer contracts to sell property to the consumer. The true retailer then contracts to purchase that property from the drop shipper and instructs the drop shipper to ship the property directly to the consumer.

In a drop shipment transaction, if both the true retailer and the drop shipper are engaged in business in California, then the usual rules apply: the drop shipper is making a sale for resale and the true retailer is liable for payment of tax to the Board. If neither the true retailer nor the drop shipper is engaged in business in California, then California cannot impose a tax collection duty on either party, and only the consumer is liable for payment to the Board of the use tax he or she owes. However, if the drop shipper is engaged in business in California but the true retailer is not, the drop shipment rule of section 6007 applies. Under such circumstances, section 6007 specifically defines the drop shipper to be the retailer of the property for purposes of the Sales and Use Tax Law.

When a drop shipper engaged in business in California makes a drop shipment to a California consumer pursuant to a retail sale made by a retailer not engaged in business in this state, the drop shipper is reclassified to be the retailer and is responsible for payment of tax as if it had contracted directly with the consumer for the retail sale of the property. The measure of tax is the true retailer’s sales price to the consumer. Thus, just as would be the case if the drop shipper had contracted directly with the consumer, if the property is drop shipped from a California location, the applicable tax is sales tax; if the property is drop shipped from a location outside this state, the applicable tax is use tax.

For example, ABC Furniture is an out-of-state company that has no physical presence in California and is thus not “engaged in business in this state” under section 6203. ABC offers for sale furniture that is manufactured by a variety of manufacturers – some of those manufacturers are engaged in business in California and others are not. When a consumer places an order with ABC (e.g., by telephone or through ABC’s website), ABC directs the manufacturer to ship the goods directly to the consumer. If the manufacturer is engaged in business in California and drop ships the furniture to a California consumer, the manufacturer is reclassified by section 6007 to be the retailer and will be liable for California tax measured by the retail selling price paid by the California consumer for the furniture. If the manufacturer drop ships the furniture from its California location, the tax is sales tax; if it drops ships the furniture from an out-of-state location, the tax is use tax.

Recent Legislative Activities

From 1939 through 1992, the provisions of section 6007 were limited to sales tax transactions – where the drop shipment was made from the drop shipper’s California location to a California consumer on behalf of the true retailer. If the drop shipment was made from an out-of-state location, the drop shipper was not reclassified to be the retailer even if the drop shipper was engaged in business in this state and the true retailer was not. Drop shippers who made their drop shipments from California inventories argued that they were at a disadvantage because potential customers purchased goods from drop shippers who avoided liability for tax by making their drop shipments from out-of-state inventories. To alleviate this competitive disadvantage against persons drop shipping from California inventories, the Board

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sponsored Senate Bill 1608 (Stats. 1992, Ch. 902) which expanded the drop shipment provision of section 6007 to include drop shipments made from out-of-state inventories.

In the 1994 legislative session, Assembly Bill 3313 (Takasugi) was introduced which would have provided drop shippers an election to provide a report to the Board with the name and address of California consumers and the retail sales price they paid to the retailer to avoid liability as a retailer under the drop shipment rule. This bill would not have alleviated the drop shippers' problems with respect to ascertaining the retail price paid by consumers since drop shippers would still have to provide the Board with such information to avoid being reclassified as the retailers. In addition, the bill would have placed the burden on the Board to collect the applicable tax directly from the consumers. This bill failed passage in the Ways and Means Committee.

In the 1995 legislative session, Assembly Bill 1761 (Alpert) was introduced which would have amended section 6007 to provide that when the amount charged for the sale of property to a retailer not engaged in business in the state exceeds \$400, the drop shipper could elect to supply the Board with the name and address of the consumer and the amount charged to the retailer and thereby avoid being reclassified as the retailer of the property. The bill was later amended to remove 6007 provisions and died in the Senate Revenue and Taxation Committee.

Most recently, in the Board's 1999 legislative proposals, the Board approved Suggestion No. 3-9 which would have amended section 6007 to eliminate the requirement that drop shippers engaged in business in California collect use tax on drop shipments made from out-of-state locations directly to California consumers pursuant to retail sales made by retailers not engaged in business in California. The Board did not find an author to carry the proposal in the 1999 legislative session.

Discussion – Constitutionality of the Drop Shipment Rule

In *Lyon Metal Products, Inc. v. State Board of Equalization* (1997) 58 Cal.App.4th 906, the Court of Appeal considered the validity of California's drop shipment rule in section 6007 and whether the Board interprets and applies it correctly. The trial court had held in favor of the plaintiff on grounds of statutory interpretation and unconstitutionality of the provision. The Court of Appeal reversed the trial court, holding that the drop shipment rule in section 6007 satisfies all requirements for constitutionality and upholding the Board's interpretation of the provision. Industry points out that the drop shipments considered by the Court in *Lyon Metal Products* were made from California locations, and that the 1992 amendments to the drop shipment rule have not been specifically tested by the courts.

Discussion – Remove Third Party Collection Responsibility or Limit to Property Shipped from California Location

Industry contends that the provisions of section 6007 place an unreasonable compliance burden on retailers registered in California. These difficulties increased in 1993 when the 1992 amendment went into effect to encompass drop shipments made to California consumers from outside this state. Industry contends that the drop shipment rule imposes an unfair administrative burden on drop shippers to collect tax on an amount that is not within their knowledge – the price the consumer paid the true retailer. Industry notes that the true retailers may be unwilling to reveal to their suppliers (i.e., the drop shippers) their mark-up on the products sold, and industry does not believe that the true retailers should be compelled to do so.

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In the meeting with staff on November 4, 1999, Mr. Miethke also noted industry's concern that a drop shipper could conceivably be charged with price fixing if it requested the dealer's selling price. However, staff disagrees. A number of states have adopted the same or similar drop shipment rule, and industry has not pointed out any instance where there has been a charge of price fixing. One reason for this is that a drop shipper who requests this information solely for tax reporting purposes would not be obtaining it for price fixing purposes, and thus, would not be liable for price fixing. Of course, if the drop shipper used the information in violation of the price fixing laws, then those laws would be properly applicable to the situation.

Industry believes that the drop shipment provisions of section 6007 encourage true retailers who are not engaged in business in California to purchase products from out-of-state, unregistered drop shippers who are not reclassified to be retailers by the drop shipment statute. Industry contends that this discriminates against companies which have a substantial commitment to California.

Discussion – Acceptance of Other States' Resale Certificates

In its letter of October 28, 1999, industry states:

California has entered into the Border Caucus agreement, under which the participants agreed to recognize each other's resale certificates. If this can be done in the Border States' context, the Board should consider whether it is legally compelled to do so generally. Again, the trend of most states is to recognize out of state resale certificates, and California is in a minority of major states who still do not do so.

In 1995, the four border states of Arizona, California, New Mexico and Texas, together with the United Mexican States, formed the Border States Caucus to create programs for promoting trade. One outcome of their discussions has been the creation of a uniform Border State "Sale for Resale" Certificate. Businesses buying goods for resale in these four states or the northern border strip and border region of Mexico may use the *Border States Uniform Sale for Resale Certificate* (Exhibit 3) for goods that will be transported across state and/or national borders.

The *Border States Uniform Sale for Resale Certificate* contains the essential elements of a standard resale certificate as explained in Sales and Use Tax Regulation 1668 *Resale Certificates*, and is used in the same manner. The certificate is used as a convenience to retailers from the participating states when they purchase resale inventory and take delivery of the merchandise in California. Often, California sellers are hesitant to accept a resale certificate from a person who does not hold a California seller's permit and may require the purchaser to provide additional documentation (e.g., a business card) to substantiate that the purchaser is a retailer of the items being purchased. The Border States Certificate was created to facilitate the acceptance of resale certificates when the purchaser does not hold a California permit, and to relieve the purchaser from having to provide additional documentation to support the nontaxable sale.

The *Border States Uniform Sale for Resale Certificate* does not affect the application of tax to drop shipments. The statement on the back of the certificate, which provides that the goods being purchased will be transported across state and/or national borders, means that the goods must be taken outside of California to be sold. Retailers registered to collect California tax cannot in good faith accept a *Border*

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States Uniform Sale for Resale Certificate from someone who does not hold a California permit when the retailer will drop ship the merchandise to a consumer in California since, by statutory definition, such drop shipments are retail sales by the drop shipper.

Staff believes that relieving drop shippers of their duty to report tax by accepting resale certificates from customers not registered with California would require amendment of section 6007. Furthermore, such an amendment would be a trap for the unwary, effectively and completely repealing the drop shipment rule except to the extent that a drop shipper fails to accept a timely resale certificate. The adoption of this proposal would mean that a transaction is regarded as a retail sale or not based solely on whether the drop shipper takes a timely resale certificate or not. This would be a departure from any other resale situation. That is, under the Sales and Use Tax Law, a sale is not defined as a sale for resale on the grounds that a resale certificate was issued. Thus, even if the seller does not take a timely resale certificate, the seller may still establish that the sale was, in fact, a sale for resale that is not taxable.

For example, if in a drop shipment transaction the true retailer is engaged in business in California, the drop shipper will almost always have sufficient documentation from the transaction to show that it was a sale for resale even if the true retailer failed to give the drop shipper a resale certificate. Regardless of the taking of the resale certificate, this transaction would be a sale for resale and the drop shipper would have the opportunity to make this showing. On the other hand, under current law, if the true retailer was not engaged in business in California, the drop shipper is the retailer. However, under the proposal to accept other states' resale certificates, the taking of a timely resale certificate would itself be the basis for a finding that the drop shipper was not the retailer. If the drop shipper failed to take such a timely certificate, there would be no facts it could show to escape that conclusion. Staff does not believe that there should be a repeal of the drop shipment rule that is so indirect that it leaves the rule in effect only to the extent that an unknowing drop shipper fails to accept a timely resale certificate from the unregistered true retailer.

Discussion - Allow Drop Shippers to Elect to Collect Tax or Report Customer Information to the Board

One reform suggested by industry would be to allow the drop shipper to elect to either collect the use tax due under the current provisions of section 6007, or to issue a report to the Board of the "ship-to" addresses of the property delivered into California. In addition to the names and addresses of the California consumer, the report could also include a description of the property and the selling price the drop shipper charged the out-of-state retailer.

Industry contends that this option alleviates the problem of imposing a tax collection duty on drop shippers who are unable to determine the final retail selling price to the consumer and those shippers who are unable to collect reimbursement from the consumer. Industry believes that this proposal provides the Board with a mechanism to bill use tax directly to the California consumer who is directly responsible for the payment of the use tax.

This proposal is not a new suggestion. As explained earlier, this suggested reform and a similar variation were previously considered by the Legislature and not passed. A problem that arises is the likelihood of an increased administrative burden to the Board from shifting the collection burden from the drop shipper/retailer to the state. Revenues are more likely to be collected by the drop shipper/retailer at the time of delivery rather than by the state several months later. In addition, in many

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cases it would not be cost effective for the Board to pursue collection from the consumer. The administrative costs of processing the information provided by the drop shipper, contacting the consumer to determine the final retail selling price of the merchandise, billing the consumer, and pursuing collection would effectively prohibit collection on small purchases. Finally, under this proposal, in order to maintain current revenue levels, the Board would have to take on a billing and collection responsibility that is currently dispersed among all affected retailers, creating a significant new workload with no revenue increase to the state.

Discussion – Ensure That Double Taxation Has Not Occurred

Industry believes the double taxation of drop shipments is potentially widespread. In its letter of October 28, 1999, Mr. Miethke states:

Because the Board, pursuant to section 6007, can recover all tax from one source (the drop shipper) it has no incentive to either 1) ensure that use tax has not been accrued and paid by the California consumer; or, 2) when auditing the California consumer, determine whether tax was collected from the drop shipper before assessing use tax on the property purchased.

Staff agrees that there is the potential for tax to be collected from both the drop shipper and the consumer on drop shipment transactions. Using the earlier drop shipment example, a manufacturer registered in California sells furniture to ABC Furniture, an out-of-state company that is not registered to collect California tax. The drop shipper ships the furniture to a consumer in California and reports California use tax on the final retail selling price to that consumer. In accordance with Sales and Use Tax Regulation 1686 *Receipts for Tax Paid to Retailers*, the drop shipper provides ABC Furniture with an invoice that separately shows the amount of use tax collected. However, ABC Furniture's sales invoice to the consumer does not show that use tax was reported by the drop shipper. Since the consumer does not have a receipt indicating use tax was paid to a registered retailer, the consumer accrues use tax and self reports it to California.

Use tax could also be collected twice on the same transaction if the drop shipper was assessed use tax in an audit, but the consumer already reported or was assessed use tax on the same transaction. Currently, there is no policy requiring that the auditor first verify that the consumer has not already reported use tax on a transaction before assessing the use tax against the drop shipper, although procedures and forms are available to do so. There is also no requirement to forward information to a registered consumer's file to report that use tax was assessed on the transaction in the audit of the drop shipper, although this may be done at the discretion of the auditor. Staff is reviewing the audit of drop shipper, Steelcase, Inc., to find out what verification procedures were done to determine the extent to which use tax may have already been remitted by the consumers. The results of the review may be used as a guideline in determining how extensive the double taxation problem is, and to develop procedures to prevent double taxation.

Another way the tax could be potentially collected twice on the same transaction would be if the drop shipper reported the use tax, but the consumer did not self report the use tax. If the Board audits the consumer and the purchase records do not show that use tax was reported by the drop shipper, the auditor would schedule the transaction and assess use tax unless the purchaser could prove that the tax was paid by a registered seller. To assist the taxpayer in proving that tax was already paid by another

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vendor on the transaction, the Board has developed the Form BOE-503 (hereafter called “ABC” Letter) procedure.

“ABC” Letter Procedure

If the purchaser believes that use tax may have already been paid to California, but does not have a receipt indicating the tax was paid by a retailer registered with California, the purchaser may utilize the “ABC” Letter procedure. The auditor will provide the purchaser with a three-part form set (Exhibit 4):

1. BOE-503-A, explains the “ABC” Letter procedure
2. BOE-503-B, Sample “ABC” Cover Letter
3. BOE-503-C, Concerning Property Purchased Without Payment of California Use Tax

The sample cover letter (BOE-503-B) and statement form (BOE-503-C) may be reproduced by the purchaser and sent out to the vendors in question to obtain their signed statements regarding the payment of use tax. Return envelopes are also provided if the taxpayer chooses the recommended procedure of having the forms returned directly to the Board. The purchaser may customize the cover letter by placing the text on the purchaser’s letterhead, and if it chooses to have the responses sent directly to the Board, it may add a statement in the cover letter asking the vendor to send a copy of the response to the purchaser by fax or mail.

The procedure explanation letter (BOE-503-A) advises the purchaser that the statement returned by the vendor will not be accepted as satisfactory proof if incomplete, if found to be untrue, or if the Board has or receives information that refutes such statement. An “ABC” response merely acts as one form of evidence of possible tax payment by the vendor and does not preclude further analysis or verification by the auditor.

Although not explained in the current version of the procedure letter, the “ABC” letters could be sent directly to a drop shipper, or forwarded to the drop shipper by the vendor. Of course, the purchaser may not be aware that a drop shipper was involved in the transaction or may not be able to identify the drop shipper from the information it receives. In the latter situation, the true retailer may be unwilling to give the drop shipper information to the customer. In addition, as Mr. Miethke points out in his October 28, 1999 submission, a problem with tracking drop shipments is that there is no common identifier number between the drop shipper’s and the true retailer’s invoicing. The questioned items can often only be tracked through delivery documents which may not be retained by the purchaser. Since the customer would use its purchase invoice number (from its vendor, not from the drop shipper) to identify the sale on the “ABC” statement letter, it may be difficult for the drop shipper to trace the transaction.

Forms BOE-1032 and BOE-1164 Procedures

At the meeting with Mr. Miethke on November 4, 1999, staff discussed the Board’s BOE-1032 *Information on Out-of-State Retailers* (Exhibit 5) and BOE-1164 *Audit Memorandum of Possible Tax Liability* (Exhibit 6) forms and how they apply to drop shipment transactions.

Form BOE-1032s are used when an auditor discovers that a taxpayer is making untaxed purchases from an out-of-state vendor. Completed forms include details regarding the purchaser, the out-of-state retailer, the sales representative, the property purchased, the use tax reported or assessed, and how the sale was solicited. The forms are sent to the Board’s Out-of-State District Office and used as investigative leads for registering out-of-state retailers who are engaged in business in California.

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In an audit of a purchaser who bought goods in a drop shipment transaction from an unregistered out-of-state retailer, the auditor would complete a BOE-1032. The information on the form would then be used to determine if the out-of-state retailer was engaged in business in California, but unregistered. A BOE-1032 would not directly ensure that use tax was not collected twice. However, while investigating a transaction in order to complete the BOE-1032, an auditor may discover that a drop shipper was involved in the transaction. This should alert the auditor to verify if the drop shipper is registered and to investigate if tax was already reported on the transaction.

Form BOE-1164 would be used when an auditor discovers that a registered drop shipper did not report the use tax as required. The completed form would show details regarding the purchaser, the drop shipper, the merchandise purchased, and the tax assessed or reported by the purchaser. The auditor would also include information regarding the unregistered out-of-state vendor to facilitate tracing the transaction through the drop shipper's records. The form would then be forwarded to the drop shipper's district of account for investigation.

V. Staff Recommendation

A. Description of the Staff Recommendation

Seek legislation to amend section 6007 to limit the drop shipment rule to drop shipments made from California as was the case prior to the 1992 amendments of SB 1608. This action would eliminate the requirement that drop shippers engaged in business in California collect use tax on drop shipments made from outside California directly to California consumers pursuant to retail sales made by retailers not engaged in business in California. Staff further recommends that staff work together with industry to develop administrative procedures to minimize the possibility that sales or use tax is inadvertently collected from both the drop shipper and the California consumer on the same transaction.

B. Pros of the Staff Recommendation

- Relieves retailers that are engaged in business in this state from the requirement to report use tax on deliveries to California consumers that they make on behalf of out-of-state retailers who are not engaged in business in this state.
- Is consistent with historical drop shipment rules in place from 1939 to 1992.
- Current administrative procedures could be modified to minimize the double collection of use tax on drop shipment transactions.

C. Cons of the Staff Recommendation

- Makes it more difficult to enforce use tax compliance on property drop shipped to consumers in California, when property is purchased from out-of-state retailers not engaged in business in this state.

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- Increases taxpayer confusion regarding when they are required to collect tax on drop shipments. A drop shipper would be reclassified to be the retailer responsible for reporting tax only on drop shipments made from California inventory.
- Re-introduces the same competitive disadvantage for retailers who drop ship property from California inventories pursuant to retail sales made by retailers not engaged in business in this state that the 1992 amendment to section 6007 sought to alleviate.

D. Statutory or Regulatory Change

Would require statutory amendment to section 6007.

E. Administrative Impact

The Board would experience a workload increase in verifying that the use tax is paid by the consumer and in subsequent billing and collection activity.

F. Fiscal Impact**1. Cost Impact**

Since the use tax reporting burden would shift from the drop shipper to the consumer, to avoid a revenue loss, the Board would incur costs to pursue collection from drop shipment consumers. This would include pursuing collection of use tax owed by individual consumers that staff would not have previously billed.

2. Revenue Impact

None. The Revenue Estimate will be provided under separate cover.

G. Taxpayer/Customer Impact

The tax reporting burden shifts from the drop shipper/retailer to the purchaser.

H. Critical Time Frames

None.

VI. Alternative 1**A. Description of the Alternative**

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Seek legislation to repeal the drop shipment provisions of section 6007 and to make all such drop shipments subject to the use tax whether shipped from California or from outside this state.

B. Pros of the Alternative

- Relieves retailers that are engaged in business in this state from the requirement to report use tax on deliveries to California consumers that they make on behalf of out-of-state retailers who are not engaged in business in this state.
- Eliminates the competitive disadvantage against retailers who drop ship property from California inventories because the change would apply to drop shipments made from both California and out-of-state inventories.

C. Cons of the Alternative

- Makes it more difficult to enforce use tax compliance on property drop shipped to consumers in California as directed by out-of-state retailers not engaged in business in this state.

D. Statutory or Regulatory Change

Would require statutory amendment to section 6007.

E. Administrative Impact

The Board would experience a workload increase in verifying that the use tax is paid by the consumer and in subsequent billing and collection activity.

F. Fiscal Impact**1. Cost Impact**

Since the use tax reporting burden would shift from the drop shipper to the consumer, to avoid a revenue loss, the Board would incur costs to pursue collection from drop shipment consumers. This would include pursuing collection of use tax owed by individual consumers that staff would not have previously billed.

2. Revenue Impact

None. The Revenue Estimate will be provided under separate cover.

G. Taxpayer/Customer Impact

The tax reporting burden shifts from the drop shipper/retailer to the purchaser.

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None.

VII. Alternative 2**A. Description of the Alternative**

Seek legislation to amend section 6007 so that a drop shipper is not liable as the retailer if it accepts a resale certificate from its customer (the true retailer), even if that customer (true retailer) is not engaged in business in California.

B. Pros of the Alternative

- Relieves drop shippers from the requirement to report tax on drop shipments to California consumers that they make on behalf of out-of-state retailers who are not engaged in business in this state, as long as they timely accept resale certificates.

C. Cons of the Alternative

- Makes it more difficult to enforce use tax compliance on property drop shipped to consumers in California as directed by out-of-state retailers not engaged in business in this state.
- Effectively repeals the drop shipment rule except to the extent that a drop shipper fails to take a timely resale certificate.
- Re-introduces the same competitive disadvantage for California retailers that the adoption of the drop shipment rule in 1939 sought to alleviate.

D. Statutory or Regulatory Change

Would require statutory amendment to section 6007.

E. Administrative Impact

The Board would experience a workload increase in verifying that the use tax is paid by the consumer and in subsequent billing and collection activity.

F. Fiscal Impact**1. Cost Impact**

Since the use tax reporting burden would shift from the drop shipper to the consumer, to avoid a revenue loss, the Board would incur costs to pursue collection from drop shipment consumers. This would include pursuing collection of use tax owed by individual consumers that staff would not have previously billed.

FORMAL ISSUE PAPERIssue Paper Number: **99-057****2. Revenue Impact**

None. The Revenue Estimate will be provided under separate cover.

G. Taxpayer/Customer Impact

The tax reporting burden shifts from the drop shipper/retailer to the purchaser.

H. Critical Time Frames

None.

VIII. Alternative 3**A. Description of the Alternative**

Seek legislation to amend section 6007 to allow a drop shipper to elect to avoid reclassification as a retailer of drop shipped property by issuing a report to the Board which includes the name and address of the consumer in California, along with a description of the property and the selling price the drop shipper charged the out-of-state retailer.

B. Pros of the Alternative

- Provides an option for those drop shippers who have difficulty in determining the selling price to the consumer and obtaining tax reimbursement from consumers.
- Provides the Board information about the California consumer to facilitate collection of the use tax.

C. Cons of the Alternative

- Reduces the likelihood of collecting the use tax on drop shipments. Revenues are more likely to be collected from a retailer than directly from the consumer.
- Shifts the collection effort to the Board. In many cases it would not be cost effective for the Board to pursue collections from these consumers.
- Creates a significant billing and collection workload for the Board without an increase in revenue to the state.

D. Statutory or Regulatory Change

FORMAL ISSUE PAPER

Issue Paper Number: **99-057**

Would require statutory amendment to section 6007.

E. Administrative Impact

The Board would experience a workload increase in verifying that the use tax is paid by the consumer and in subsequent billing and collection activity.

F. Fiscal Impact

1. Cost Impact

Since the use tax reporting burden would shift from the drop shipper to the consumer, to avoid a revenue loss, the Board would incur costs to pursue collection from drop shipment consumers. This would include pursuing collection of use tax owed by individual consumers that staff would not have previously billed.

2. Revenue Impact

None. The Revenue Estimate will be provided under separate cover.

G. Taxpayer/Customer Impact

The tax reporting burden shifts from the drop shipper/retailer to the purchaser.

H. Critical Time Frames

None.

IX. Alternative 4

A. Description of the Alternative

Seek legislation to amend section 6007 to limit the drop shipper's measure of tax to the amount they charged their customer (the true retailer) and to make all such drop shipments subject to use tax so that the California purchaser/consumer is liable for tax on the entire transaction, but is allowed a credit for tax already paid by the drop shipper.

B. Pros of the Alternative

- Provides relief for those drop shippers who have difficulty in determining the selling price to the consumer.
- State will collect majority of tax from a small number of drop shippers rather than identifying and billing a large number of consumers.

FORMAL ISSUE PAPER

Issue Paper Number: **99-057**

C. Cons of the Alternative

- Still potential for double reporting of tax on same transaction. May be difficult for California consumer/purchaser to determine if, and what amount of use tax was previously paid by the drop shipper on the transaction.
- Difficult for the Board to determine the amount of credit due the California consumer/purchaser for tax paid by the consumer and also by the drop shipper.

D. Statutory or Regulatory Change

Would depend on outcome of legislation.

E. Administrative Impact

The Board would experience a workload increase in verifying that the use tax is paid by the consumer and in subsequent billing and collection activity.

F. Fiscal Impact

1. Cost Impact

Since the use tax reporting burden would shift from the drop shipper to the consumer, to avoid a revenue loss, the Board would incur costs to pursue collection from drop shipment consumers. This would include pursuing collection of use tax owed by individual consumers that staff would not have previously billed.

2. Revenue Impact

None. The Revenue Estimate will be provided under separate cover.

G. Taxpayer/Customer Impact

The tax reporting burden shifts from the drop shipper/retailer to the purchaser.

H. Critical Time Frames

None.

Prepared by: Program Planning Division, Sales and Use Tax Department

Current as of: November 22, 1999

**BOARD OF EQUALIZATION
REVENUE ESTIMATE**

DROP SHIPMENTS

Staff Recommendation

Staff recommends the Board seek legislation to amend Revenue and Taxation Code section 6007 to limit the drop shipment rule to drop shipments made from California as was the case prior to the 1992 amendments of SB 1608. This action would eliminate the requirement that drop shippers engaged in business in California collect use tax on drop shipments shipped from outside California directly to California consumers pursuant to retail sales made by retailers not engaged in business in California. Staff further recommends that staff work together with industry to develop administrative procedures to ensure that sales or use tax is not collected from both the drop shipper and the California consumer on the same transaction.

Alternative 1

Seek legislation to repeal the drop shipment provisions of section 6007 and to make all such drop shipments subject to the use tax whether shipped from California or from outside this state.

Alternative 2

Seek legislation to amend section 6007 so that a drop shipper is not liable as the retailer if it accepts a resale certificate from its customer (the true retailer), even if that customer (the true retailer) is not engaged in business in California.

Alternative 3

Seek legislation to amend section 6007 to allow a drop shipper to elect to avoid reclassification as a retailer of drop shipped property by issuing a report to the Board which includes the name and address of the California purchaser/consumer along with a description of the property and the selling price the drop shipper charged the out-of-state retailer.

Alternative 4

Seek legislation to amend section 6007 to limit the drop shipper's measure of tax to the amount they charged their customer (the true retailer) and to make all such drop shipments subject to use tax so that the California purchaser/consumer is liable for tax on the entire transaction, but allowed a credit for tax already paid by the drop shipper.

Background, Methodology, and Assumptions

Staff Recommendation:

Prior to 1993, drop shippers engaged in business in California were not required to collect the use tax on drop shipments to California consumers. Section 6007 of the Revenue and Taxation Code only required that California suppliers making deliveries of goods from California locations to California consumers on behalf of out-of-state retailers collect the sales tax on these transactions.

SB 1608 (Stats. 1992, Ch. 902) expanded Section 6007 to require suppliers doing business in California to collect the use tax on drop shipments made from out-of-state locations to California consumers. This proposal would eliminate that requirement.

A review of a number of recent audits done by the Sales and Use Tax Department (SUTD) on drop shippers engaged in business in California identified and billed \$1.7 million in unreported annual use tax revenue on drop shipments.

The Board, on July 28, 1998 determined that eliminating the requirement that out-of-state retailers engaged in business in California collect use tax on drop shipments to California end users results in removing the liability for the tax from the drop shipper but does not change the liability of the end-user for the tax and therefore, would have no revenue effect.

Alternative 1:

Alternative 1 would repeal the drop shipment provisions of section 6007 and make all such drop shipments subject to the use tax whether shipped from California or from outside this state.

In a drop ship transaction, if the goods are shipped to the California end user from a location inside California, the transaction is a sales tax transaction. If the goods are shipped from a location outside California to the end-user in California, the transaction is subject to use tax. This proposal would make all drop shipment transactions use tax transactions and relieve shippers of tax liabilities for all drop shipment transactions.

The amount of current use tax revenue would be the same as in the staff recommendation, \$1.7 million annually.

Recent audits have identified unreported sales and use tax revenue amounting to \$1.3 million in "disallowed interstate commerce sales – instate deliveries". While this amount includes both sales tax and use tax drop shipments, it is estimated that the majority of this noncompliance amount involves sales tax transactions. While we do not know the total amount of sales tax drop shipment transactions, it is estimated that sales tax drop shipment transactions yield considerably more revenue than use tax transactions. It is estimated that sales tax revenue on sales tax drop shipment transactions amounts to between \$2 million and \$5 million annually.

Under this proposal, all of these transactions would be subject to the use tax. The total use tax revenue that would be effected by this proposal would be between \$3.7 million and \$6.7 million annually.

The Board, on July 28, 1998 determined that eliminating the requirement that out-of-state retailers engaged in business in California collect use tax on drop shipments to California end users results in removing the liability for the tax from the drop shipper but does not change the liability of the end-user for the tax and therefore, would have no revenue effect.

Alternative 2:

Alternative 2 would amend section 6007 so that a drop shipper is not liable as the retailer if it accepts a resale certificate from its customer (the true retailer), even if that customer (the true retailer) is not engaged in business in California.

This proposal would enable drop shippers to accept out-of-state vendors' resale certificates thereby effectively exempting drop shippers from the tax collection responsibility and placing the liability onto the consumers. This proposal would involve the same amount of revenue as detailed in Alternative 1 - \$3.7 million to \$6.7 million annually.

The Board, on July 28, 1998 determined that eliminating the requirement that out-of-state retailers engaged in business in California collect use tax on drop shipments to California end users results in removing the liability for the tax from the drop shipper but does not change the liability of the end-user for the tax and therefore, would have no revenue effect. The same logic would apply to sales tax drop shipment transactions.

Alternative 3:

Alternative 3 would amend section 6007 to allow a drop shipper to elect to avoid reclassification as a retailer of drop shipped property by issuing a report to the Board which includes the name and address of the California purchaser/consumer along with a description of the property and the selling price the drop shipper charged the out-of-state retailer.

This proposal would involve the same amount of revenue as detailed in Alternative 1 - \$3.7 million to \$6.7 million annually.

The Board, on July 28, 1998 determined that eliminating the requirement that out-of-state retailers engaged in business in California collect use tax on drop shipments to California end users results in removing the liability for the tax from the drop shipper but does not change the liability of the end-user for the tax and therefore, would have no revenue effect. The same logic would apply to sales tax drop shipment transactions.

Alternative 4:

Alternative 4 would amend section 6007 to limit the drop shipper's measure of tax to the amount they charged their customer (the true retailer) and to make all such drop shipments subject to use tax so that the California purchaser/consumer is liable for tax on the entire transaction, but allowed a credit for tax already paid by the drop shipper.

This proposal would relieve the drop shipper of a portion of the tax liability on drop shipments. While the consumer is not relieved of any liability, he/she is allowed a credit for the amount of tax paid by the drop shipper. This means that the consumer needs to pay the tax on the difference between the amount the drop shipper charged the true retailer and the amount the true retailer charged the consumer.

This proposal would involve the same amount of revenue as detailed in Alternative 1 - \$3.7 million to \$6.7 million annually. However, a portion of this amount is currently being collected by the drop shipper and a portion would need to be collected from the consumer.

The Board, on July 28, 1998 determined that eliminating the requirement that out-of-state retailers engaged in business in California collect use tax on drop shipments to California end users results in removing the liability for the tax from the drop shipper but does not change the liability of the end-user for the tax and therefore, would have no revenue effect.

Revenue Summary

Staff Recommendation:

The staff recommendation has no revenue effect.

Alternative 1:

Alternative 1 has no revenue effect.

Alternative 2:

Alternative 2 has no revenue effect.

Alternative 3:

Alternative 3 has no revenue effect.

Alternative 4:

Alternative 4 has no revenue effect.

Qualifying Remarks

The above estimates assume that all of the sales and use tax liability now being paid by the drop shippers will be paid by the end users. However, this revenue is more likely to be collected from the retailer at the time of delivery than by the Board several months later. In many cases, it would not be cost effective for the Board to pursue collection on the end user. The administrative costs of processing the information provided by the drop shipper, contacting the end user to determine the final retail selling price of the merchandise, billing the end user, and pursuing collection would prohibit collection on small purchases.

Preparation

This revenue estimate was prepared by David E. Hayes, Statistics Section, Agency Planning and Research Division. This revenue estimate was reviewed by Ms. Laurie Frost, Chief, Agency Planning and Research Division and Ms. Freda Orendt-Evans, Program Planning Manager, Sales and Use Tax Department. For additional information, please contact Mr. Hayes at (916) 445-0840.

Current as of November 23, 1999

Application of Tax to Drop Shipments Current as of 11/22/99

Item	Staff's Proposed Action	Industry's Proposed Action	Summary Comments
<p>Action Item 1: Consent Item Administrative procedures.</p> <p>Action Item 2: “Apply Drop Shipment Rules Only to Drop Shipments from California”</p> <p style="text-align: center;">OR</p> <p>“Repeal the Drop Shipment Provisions of Section 6007 and Make All Drop Shipments Use Tax Transactions”</p> <p style="text-align: center;">OR</p>	<p>Staff and Industry will work together to develop administrative procedures to minimize the possibility that use tax is inadvertently collected from both the drop shipper and the California end user on the same transaction.</p> <p>Seek legislation to amend section 6007 so that the drop shipment rules only apply to drop shipments from California, as was the case prior to the 1992 amendment to section 6007. This action would eliminate the requirement that drop shippers engaged in business in California collect use tax on drop shipments made from outside California directly to consumers in California pursuant to retail sales made by retailers not engaged in business in California.</p> <p>Do not seek legislation for this item.</p>	<p>Staff and Industry will work together to develop administrative procedures to ensure that use tax is not collected from both the drop shipper and the California end user on the same transaction.</p> <p>Do not seek legislation for this item.</p> <p>Seek legislation to amend section 6007 to repeal the drop shipment provisions and to make all such drop shipments subject to use tax whether shipped from California or from outside this state.</p>	<p>Staff and Industry agree that administrative procedures should be developed to minimize the double collection of tax on a transaction.</p> <p>Staff believes this action would provide relief for most of the drop shippers who experience difficulties in complying with the current drop shipment rules. Action is consistent with historical drop shipment rules in place from 1939 to 1992.</p> <p>one faction of industry does not directly oppose this action, but would prefer the Board support action which would relieve drop shippers of liability in both sales and use tax transactions.</p> <p>Another faction of industry does not support this action because it discriminates against drop shippers who ship from California locations.</p> <p>Industry supports this action because it relieves all drop shippers from the responsibility to report tax on property they drop ship to California consumers at the request of out-of-state retailers not engaged in business in California.</p> <p>Staff does not support this action because it creates a competitive disadvantage for</p>

Application of Tax to Drop Shipments Current as of 11/22/99

Item	Staff's Proposed Action	Industry's Proposed Action	Summary Comments
<p>“Relieve Drop Shipper of Liability if They Accept a Resale Certificate from the True Retailer, Even if that Retailer is Not Engaged in Business in California”</p> <p>OR</p> <p>“Allow Drop Shipper to Avoid Reclassification as a Retailer of Drop Shipped Property by Issuing a Report to the Board which Includes Relevant Information About the Transaction”</p> <p>OR</p> <p>“Limit Drop Shipper’s</p>	<p>Do not seek legislation for this item.</p> <p>Do not seek legislation for this item.</p>	<p>Seek legislation to amend section 6007 so that a drop shipper is not liable as the retailer if it accepts a resale certificate from the true retailer, even if that retailer is not engaged in business in California.</p> <p>Seek legislation to amend section 6007 to allow a drop shipper to avoid reclassification as a retailer of drop shipped property by issuing a report to the Board which includes the name and address of the California purchaser/consumer along with a description of the property and the selling price the drop shipper charged the out-of-state retailer.</p>	<p>California retailers who sell directly to consumers in California.</p> <p>Industry supports this action because it relieves all drop shippers from the responsibility to report tax on property they drop ship to California consumers at the request of out-of-state retailers not engaged in business in California.</p> <p>Staff does not support this action because it creates a competitive disadvantage for California retailers who sell directly to consumers in California.</p> <p>Industry supports this action because it relieves all drop shippers from the responsibility to report tax on property they drop ship to California consumers at the request of out-of-state retailers not engaged in business in California. This action also provides the Board with information to directly pursue use tax collection from the California consumer.</p> <p>Staff does not support this action because it creates a competitive disadvantage for California retailers who sell directly to consumers in California. Also creates a significant new workload for the Board with no revenue increase to the state.</p>

Application of Tax to Drop Shipments
Current as of 11/22/99

Item	Staff's Proposed Action	Industry's Proposed Action	Summary Comments
Measure of Tax to the Amount They Charged Their Customer (the True Retailer) and to Make all Such Drop Shipments Use Tax"	Do not seek legislation for this item.	Seek legislation to amend section 6007 to limit the drop shipper's measure of tax to the amount they charged their customer (the true retailer) and to make all such drop shipments subject to use tax so that the California purchaser/consumer is liable for tax on the entire transaction, but allowed a credit for tax already paid by the drop shipper.	This action would provide relief for drop shippers who have difficulty in determining the selling price of the property to the end consumer. However, industry would prefer to seek legislation that would relieve drop shippers from the responsibility to report the tax entirely.

LAW OFFICES OF
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PARRINELLO, MUELLER & NAYLOR, LLP**

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October 28, 1999

Ms. Freda Orendt-Evans
Program Planning Manager
Sales and Use Tax Department
State Board of Equalization
450 N Street MIC:92
Sacramento, CA 95814

RECEIVED
OCT 28, 1999

PROGRAM PLANNING MANAGER

Re: December 7, 1999 Business Tax Committee Issue: Sales
and Use Tax Treatment of Drop Shipments

Dear Freda:

Pursuant to my conversation with Paul Steinberg, Esq. of Mr. Andal's office, enclosed is an issue paper presenting the views of our client, Steelcase Inc., on drop shipments.

After you have had a chance to review this paper, please call me at (916) 446-6752 to arrange a brief meeting to discuss it.

I look forward to hearing from you.

Sincerely,

/s/ Eric J. Miethke

Eric J. Miethke

EJM/cm
Enclosure

cc: Paul Steinberg, Esq.

INDUSTRY ISSUE PAPER ON DROP SHIPMENT ISSUE

Introduction

This paper is presented by Steelcase Inc., the largest manufacturer of office furniture in the United States. Steelcase has 42 production plants worldwide, employs over 21,000 people and had sales in 1998 of approximately \$3.4 billion.

Steelcase has a major presence in California, operating 12 business locations which include manufacturing, research and development and sales facilities. Steelcase employs about 1,900 people in California. The company also is a major taxpayer in the state, with sales tax payments of about \$2.9 million, income tax payments of \$2.7 million, employment taxes of \$4.2 million and property taxes of about \$1.1 million to support all levels of government. As a conscientious corporate citizen, Steelcase has made donations to California non-profit charities of over \$300,000 each year.

Few of Steelcase's sales are directly to the ultimate consumer of the product. Steelcase sells office furniture in every country in the world through independently-owned dealers. Because Steelcase sells its products in this fashion, the taxation of drop shipments are a major issue for Steelcase and similarly situation manufacturer/suppliers throughout the United States.

What is a "Drop Shipment"?

A drop shipment is actually not a single sales transaction at all, but a three-party transaction that involves two separate sales. The first sale is made by a manufacturer/supplier to a dealer or retailer. The second sale is from the dealer/retailer to the California end user. What distinguishes a drop shipment is an instruction from the dealer/retailer to the manufacturer/supplier to ship the property directly to the end user, who is located in California. Under normal circumstances, a fact pattern such as this would be an exempt sale for resale from the manufacturer/supplier to the dealer/retailer, followed by a taxable sale by the dealer/retailer to the customer. However, when the dealer/retailer is located outside California and is not "engaged in business" in California, and the manufacturer/supplier has a physical presence in California, Revenue and Taxation Code section 6007 deems the transaction to be *a retail sale by the manufacturer/supplier to the customer*. More incredibly, the measure of tax is not the amount charged by the manufacturer/supplier to the dealer/retailer, but is the amount charged by the dealer/retail to the customer.

There are two variations of the drop shipment theme. If the property in question is shipped to the California end user from a location inside of California, the transaction is deemed to be a sales tax transaction; however, if the property in question originates from a location outside of California, the drop shipment is deemed to be a use tax transaction. In either case, however, the "drop shipper" (the manufacturer/supplier), rather than the retailer, is liable for

collecting and paying the sales or use taxes on the transaction.

Prior to 1992, section 6007 only applied to transactions where the property in question was delivered in California (the first variation of the fact pattern). However, SB 1608 passed in the 1992 session of the legislature which revised the language of the statute to include within the definition of a drop shipment those transactions where the property was not delivered by the manufacturer/supplier in California, but from outside the state (second scenario). Different legal issues are presented by this expansion of the law (see below).

In summary, however, under the California drop shipment statute, the manufacturer/supplier is required to pay tax on a sale it *never made* to a California purchaser *who is not its customer* on a price that the manufacturer/supplier *never set or charged*.

Contrast With Mail Order/E-Commerce

It is important to understand that the drop shipment issue is not the same as the use tax collection issue of mail order sales or e-commerce. Mail order companies typically are located outside of California, where the order is also taken from the customer. The customer in the mail order situation, however, is the customer of the mail order seller. If the mail order seller has sufficient physical presence ("nexus") in California (Revenue and Taxation Code section 6203), the mail order company is legally required to collect use tax from its California customer. The difference, however, is that the mail order seller is collecting tax on *its* sale from *its* customer, measured by *its* sales price. This situation, which places a reasonable compliance burden on the seller, is completely different than the drop shipment situation faced by Steelcase and others.

Repeal or Reform of Drop Shipment Policies Sought

Steelcase seeks to repeal or greatly reform California's statutes and policies concerning drop shipments, because they are bad for California and California taxpayers. Changes are sought for several reasons:

A. Forced Tax Collection

California's drop shipment policies deem someone making a sale for resale (the manufacturer/supplier) to be a retailer, and imposes sales tax collection responsibility on them. This occurs despite the fact that the actual retail sale is being made by someone completely unrelated to the manufacturer/supplier (in Steelcase's case, the independently-owned dealership). It simply is not fair to impose this compliance cost and responsibility on one party for the sales activity of another.

B. Penalty Imposed for Inability to Meet Impossible Compliance Burden

Steelcase and other drop shippers are being penalized for their inability to meet an

impossible administrative burden. Because tax liability is imposed not on the drop shippers sale price, but on the dealer/retailer's price, the drop shipper has no way to accurately determine tax liability, even if there were an effective way to collect it. Second, there is no effective way to track sales through Steelcase's customer (the dealer/retailer) to the ultimate customer, since there are two completely different invoices with different invoice numbers between the parties and no way to cross-reference them. Their invoice from the dealer to the ultimate California customer, moreover, may have multiple products and services sourced from within and without California on it, further complicating compliance. Finally, since the California consumer of the goods is not the customer of the drop shipper, there is no contractual way for the drop shipper (Steelcase) to compel reimbursement of taxes due from the ultimate customer in any regard.

C. Discrimination Against Companies with California Locations and Jobs

The existing drop shipment policy encourages customers to purchase products from out-of-state, non-registered vendors who are not deemed "retailers" by the drop shipment statute, nor are obligated to collect use tax on the transaction. This discrimination against companies like Steelcase who have a substantial commitment to California is an unwarranted penalty in the tax system.

D. California in the Minority of States With Drop Shipment Problem

California's drop shipment policies are in stark contrast to most states which have either always recognized or have recently moved towards recognition of resale certificates issued by out-of-state retailers. Indeed, recognition of such resale certificates is even part of the Border States' agreement to which California is a party. It is unclear how the Board staff plans to treat such a pact in light of Revenue and Taxation Code section 6007.

E. California May Have Substantial Exposure if the Drop Shipment Statute is found Unconstitutional

There are significant constitutional issues associated with drop shipments. Prior to 1997, there had not been a reported California appellate court opinion on the legality of Revenue and Taxation Code section 6007. However, in *Lyon Metal Products v. State Board of Equalization*, 58 Cal. App. 4th 906 (1997), the drop shipment statute was upheld as applied to a transaction where the property was delivered by the manufacturer/supplier in California (scenario one in the Introduction). The taxpayer had argued, and the trial court had found, that the drop shipment statute violated the commerce clause of the United States Constitution.

Despite this single case, constitutional issues remain:

1. Statutory Analysis Questionable

The *Lyon Metal* court concluded that the taxpayer had failed to rebut the presumption of

section 6091, that all gross receipts are subject to the sales tax until the contrary is established, even though the taxpayer had shown that the delivery in California to the consumer was preceded by a sale by the manufacturer/supplier to an out-of-state retailer. The Court basically stated that unless the California recipient of the goods were going to resell them, the "sale for resale" exclusion from section 6091 didn't apply. There was no analysis and no support for this notion that section 6007 in essence reads the sale for resale exemption out of the law for resales to customers outside California. Moreover, the court seemed to presume the validity of section 6007 at the outset of its analysis. In fact, Lyon's "sale" was not to the California consumer, but to an out-of-state retailer. The Court presumed that Lyon's sale was to the California customer of the out-of-state retailer for the purposes of its analysis of the resale exclusion. This confusion makes the court's analysis and conclusion suspect.

2. Commerce Clause Analysis Flawed

The *Lyon Metal* court simply erred in their Commerce Clause analysis. The Court found no violation of the Commerce Clause because it believed that the drop shipment rule resulted in the same tax due on the consumer's purchase whether it was made from an in-state or out-of-state retailer, essentially finding the drop ship rule functioned as a surrogate use tax. However, the court completely missed the correct Commerce Clause analysis, which is not to measure the transaction from the standpoint of the customer, but from the standpoint of the retailer complaining of the discrimination against interstate commerce. Had Lyon made it sale to a California retailer, it would have been a sale for resale and excluded from Lyon's gross receipts. If Lyon's had made its sale to a California retailer, who ordered Lyon to deliver it to the retailer's California customer, it still would have been a sale for resale. However, when Lyon made the identical sale to a retailer not engaged in business in California (i.e., in interstate commerce) it became liable for sales tax. The Court's failure to recognize this simple fact, and their confusion over who is liable for the sales tax (the retailer or drop shipper, not the customer) makes the deficiency of the analysis glaring.

3. Measure of Tax, Acceptance of Other States' Resale Certificates

Because the drop shipment statute measures liability not based on the manufacturer/supplier price to its customer, but on the retailer's price to the consumer, a substantial due process issue is presented that was never argued by the taxpayer in *Lyon Metal*. The most one can say is that the Court mentioned the problem briefly in a footnote, although its somewhat simplistic solution was "to ask the wholesaler this question when the delivery in California was ordered". The Court was not presented (apparently) with any evidence that such conversations regarding pricing of products may create antitrust issues for both manufacturers and retailers of products.

Moreover, it is unclear whether the taxpayer in *Lyon Metal* argued that California had an obligation under the Commerce Clause to recognize the resale certificates from another state. The Court seemed to suggest that this issue was not raised by the taxpayer (58 Cal. App. 4th 906, 911).

A real issue exists, particularly given the high level of cooperation between the states on information sharing, compacts, etc., whether states are legally compelled to recognize other states' resale certificates as evidence that a sale by a California taxpayer is for resale.

4. *Lyon Metal Does Not Apply to the 1992 Amendments to Section 6007*

It should also be noted that *Lyon Metal* only dealt with property shipped from within California. The 1992 amendments to section 6007 cast a much broader net over a much greater universe of transactions---those where the property is shipped from outside of California. Where title and risk of loss passes from the manufacturer/supplier to the retailer at a point outside of California, and the goods are shipped via common carrier into California to the ultimate consumer, a much more difficult constitutional burden for the State of California is presented. The sale from the manufacturer/supplier to the retailer occurred outside the state, and not even delivery to the customer by the retailer was made in California. Added to the other problems presented by drop shipment discussed in this paper, there should be substantial doubt as to whether the 1992 additions to section 6007 would be sustained by the Courts.

Because these substantial legal issues exist which create exposure for California, a solution to the drop shipment situation should be found.

Options for Reform

Steelcase asks the Board to consider the following options for complete or partial resolution of the drop shipment issue. Some of these proposals can be addressed administratively while others will require legislative intervention:

A. *Remove Third Party Collection Responsibility*

Section 6007 deems a drop shipment to be a retail sale by the manufacturer/supplier if the property is shipped from within California, and a use tax transaction with collection responsibility placed on the manufacturer/supplier when the property is shipped from a point outside the state. Section 6007 could be modified to make both transactions use tax transactions, coupled with a recognition that the sale by the manufacturer/supplier to the out-of-state retailer is a sale for resale. This would relieve the manufacturer/supplier from the responsibility to collect tax on a sale that they did not make to a customer that is not their own.

B. *Recognition of Other States' Resale Certificates*

California has entered into the Border Caucus agreement, under which the participants agreed to recognize each other's resale certificates. If this can be done in the Border States' context, the Board should consider whether it is legally compelled to do so generally. Again, the trend of most states is to recognize out of state resale certificates, and California is in a minority of major states who still do not do so.

C. "Election Option" to Collect Tax or Report to Board of Equalization

A third possible reform would be to allow the manufacturer/supplier to elect to either collect the tax due under the current drop shipment law, or issue a report to the Board of Equalization of ship-to addresses of property delivered in this state in order to facilitate use tax collection by the Board. This is the approach currently adopted by the Board in Regulation 1574. This option is appropriate because, notwithstanding section 6007, the manufacturer/supplier is a third party in relation to the taxable transaction, and it is inappropriate to impose tax collection responsibility on them. On the other hand, by providing the Board with a list of customers, both registered and unregistered, a mechanism is provided for the Board to bill use tax directly to the customer who is directly responsible for the payment of the tax.

D. Limit Drop Shipment Statute to Property Shipped from a California Location

Former Board Member Dronenburg championed legislation to repeal the 1992 amendments to section 6007. He did so partially because he realized that the policy rationale advanced in support of the drop shipment statute did not apply in the broader situation where the property was shipped from a point outside the state. The stated purpose of section 6007, as recognized by the *Lyon Metal* court, was to prevent collusion between a California seller and a California buyer whereby they make a taxable sale nontaxable by creating an out-of-state intermediary who "purchases" the desired goods from the California seller and then "resells" them to the California customer, and arrange delivery of the property directly to the California customer by the California seller. Ignoring for the moment the fact that few drop shipments actually involve any contact between the California manufacturer/supplier and the ultimate consumer of the goods, let alone any collusion between the two, where the goods are shipped from outside the state and there is no involvement by a California seller, the policy argument does not apply. At the very least, section 6007 should be amended to repeal the 1992 amendments.

E. Ensure Double Taxation Has Not Occurred (Partial Solution)

Currently because of lack of incentives and difficulties with documentation described above, Steelcase believes that double taxation of drop shipments is potentially widespread. Because the Board, pursuant to section 6007, can recover all tax from one source (the drop shipper) it has no incentive to either, 1) ensure that use tax has not been accrued and paid by the California consumer; or, 2) when auditing the California consumer, determine whether tax was collected from the drop shipper before assessing use tax on the property purchased. Moreover, because of the problems with different invoices and purchase orders passing between the manufacturer/supplier and retailer and between the retailer and end user, it is very difficult for the taxpayers to ensure that tax is collected only once.

Because the Board has the ability to access all the records, and taxpayers cannot get access to records of other taxpayers (particularly those that are not even their customers), the Board

should bear the burden of establishing that tax was not assessed against or accrued and paid by the end user before assessing the tax against the drop shipper. Moreover, in the short run, Board staff should work together with industry to determine how extensive the double-taxation problem is, and what administrative steps can be taken to minimize or eliminate the problem.

Revenue Effect

Steelcase suspects that a substantial portion of drop shipments are to customers who are either already registered with the Board and self-accruing their use taxes on such purchases, or are direct pay permit holders who are accruing use tax on their purchases, thus presenting the situation where revenues attributed to drop shipment statutes are actually doubling collected and counted. Therefore, even if the drop shipment rules are completely repealed, revenue impact should be minimal. Moreover, any revenue effects reform or repeal created could be mitigated by some of the options presented above, such as providing the Board with the ship-to addresses in California to facilitate use-tax billing.

Conclusion

Manufacturer/suppliers like Steelcase are currently required to collect tax on sales that are not their own, from people that are not their customers on an amount they did not charge. Because of the limitations discussed in this paper, compliance is for all practical purposes impossible; moreover, it is currently impossible for a manufacturer/supplier to ascertain whether tax assessed against them has already been paid by the ultimate customer. Taken as a whole, the California drop shipment tax regime is an unfair penalty against Steelcase and companies similarly situated. Moreover, because a California customer who wants to avoid taxation can do so by purchasing from an out-of-state vendor does not utilize a California manufacturer/supplier, the drop shipment rules discriminates against companies making a commitment to California and encourages commerce to be shifted to other states.

Steelcase expresses its appreciation to the Board for the opportunity to re-examine this issue, and welcomes the opportunity to work with staff to develop administrative and legislative solutions to address the challenges presented herein.



BORDER STATES UNIFORM SALE FOR RESALE CERTIFICATE

Accepted in Arizona, California, New Mexico and Texas

This certificate is to be completed by the purchaser and furnished to the vendor who shall retain it. Incomplete certificates must not be accepted in good faith.

SELLER INFORMATION

Seller: _____

Street Address: _____

City, State, Country, Zip Code: _____

PURCHASER INFORMATION

Purchaser: _____

Street Address: _____

City, State, Country, Zip Code: _____

I am engaged in the business of _____

The **property** is purchased for resale, and will be resold in the state(s) or country noted below for which I have valid business tax permit(s):

		Permit/Identification	Number
a State	_____	_____	_____
b State	_____	_____	_____
c country	United States	_____	_____
d Country	United Mexican States	_____	_____

Description of the property being purchased _____

5 Check Applicable Box:



Single **Purchase** Certificate



Blanket Certificate

CERTIFICATION

I understand that if I make any **use** of the item other than retention, demonstration, or display while holding it for sale in the regular course of **business**, I must pay use **tax** in that state or country measured by the purchase price of such property or other authorized amount. I further understand it may be a **criminal** offense to give a **seller** a resale certificate for a taxable item which I know, at the time of purchase, is purchased for use rather than for the purpose of resale, lease or rental. I certify **that** these **purchases** are exempt per the appropriate **laws** of the state or country of purchase and that the **information** on this certificate is **true**, accurate and **complete**.

Signature of Purchaser _____ Date _____

Title _____

BORDER STATES UNIFORM SALE FOR RESALE CERTIFICATE

The four border states of Arizona, California, New Mexico and Texas, together with the United Mexican States have formed the Border States Caucus to work out programs to promote trade in the southwest region of the United States of America in accordance with the objectives set out under NAFTA. The caucus has developed the attached certificate to simplify transactions in accordance with the objective set out under the NAFTA Agreement in the border area. Businesses buying goods for resale in these states or the northern border strip and border region of Mexico which will be transported across state and/or national borders may use this certificate in lieu of a state resale certificate. Goods are materials and other tangible property. The certificate must be completed by the buyer and given to the seller. The seller must retain this document as part of its accounting records. The seller must not accept an incompleated document as it may be invalid. Similarly the seller must insure the claim is applicable, that is, the type of goods fits the description of the purchaser's business and are likely for resale in that business. Laws vary by jurisdiction so that misuse of this certificate by a purchaser may be a criminal offense or a civil penalty. Regardless, all competent authorities of the respective jurisdictions will actively validate use of this certificate and vigorously pursue appropriate legal action for its misuse. If you believe this purchase is tax exempt for other reasons than resale you must use the local state form to claim that exemption.

SELLER INFORMATION

Enter the name and address of the seller at the top of the form.

PURCHASER INFORMATION

1. Enter your business name and address exactly as shown on the State or Federal Business Tax Permit for the location of the business which is reselling these goods. Business tax permit means the license or registration provided by the jurisdiction for sales, transaction privilege, gross receipts or value added taxes. United States purchasers enter both your state business permit number and your federal taxpayer identification number. The United States taxpayer identification number is either your FEIN (federal employer identification number) or your SSN (social security number) if you do not have employees. The United Mexican States taxpayer identification number is the RFC (federal taxpayers registry). The following describes the state taxes and their license or permit numbering which apply to this form.

STATE / COUNTRY**TYPE OF TAX****TYPE OF LICENSE/PERMIT/NUMBER ISSUED**

Arizona	Transaction Privilege Tax	Transaction Privilege Tax License
California	Sales Tax	Sales Tax License
New Mexico	Gross Receipts Tax	Taxpayer Identification number
Texas	Sales Tax	Texas Taxpayer number
United Mexican States		Federal Taxpayers Registry (RFC)
United States of America		Taxpayer Identification number (TIN)

2. You must describe the nature of your business so the seller can determine that your purchase for resale is valid.
3. If you are purchasing goods for resale in more than one state or country enter the name and permit number on the line provided for each jurisdiction. On lines 3a and 3b, enter the state and your permit or identification number of each state to which these goods are being shipped for resale. If you will be reselling these goods in more than two states use another copy of this form for the additional state information. On line 3c, if you are a U. S. Business enter your U. S. taxpayer identification number. On line 3d, if you are a Mexican Business enter your Federal Taxpayers Registry.
4. Describe the goods being purchased.
5. Check the box indicating if this certificate applies to this single purchase or for a series of purchases. You may elect to file a blanket certificate if you will be buying the same material from the same vendor for resale at the same location over a period of time. Do not check this box unless you expect to make repeated purchases. **NOTE:** Some states limit the length of period one certificate can cover. Call your local agent or tax authority for information.

CERTIFICATION

By completing and signing this certificate you are attesting to the validity of the document. Buyers should understand that if they later use the property purchased for resale for their own use it will be subject to local use or related taxes. Exemption certificates accepted by United States vendors from Mexican merchants must have a copy of their duly authorized Mexican Registration Form.



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA

(PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-00XX)

TELEPHONE (916)

FAX (916)

JOHAN KLEHS
First District, HaywardDEAN F. ANDAL
Second District, StocktonCLAUDE PARRISH
Third District, TorranceJOHN CHIANG
Fourth District, Los AngelesKATHLEEN CONNELL
Controller, SacramentoE. L. SØRENSEN, JR.
Executive Director**Tax Permittee****Use of “ABC” Letter Procedure to Verify Payment of Use Tax by Out-of-State Sellers**

This letter summarizes the sample letter procedure explained to you by our auditor. The auditor questioned certain ex-tax purchases made by you. Under the California Sales and Use Tax Law, you as the purchaser are liable for payment of the tax unless you can present satisfactory evidence (e.g., a receipt) that the tax was paid to a seller holding a California seller's permit or a Certificate of Registration-Use Tax.

The “ABC” letter procedure outlined in this document is recommended by the Board as a method by which you, the purchaser, can help to satisfy your use tax obligation. You are not bound to use these procedures and can present any other satisfactory evidence, such as a receipt.

The attached sample letter (BOE-503-B) and statement form (BOE-503-C) are provided for your convenience. You may reproduce the statement form and send it to the vendor(s) in question to obtain their signed statements regarding the payment of use tax. If you choose the recommended procedure to have the forms returned directly to the Board, the auditor will provide return envelopes. However, if you decide to use the “ABC” process and you choose to have the forms returned directly to you instead of the Board, the likelihood of having staff contact your vendor or sending an additional mailing will be greater. In order to communicate fully with your vendor(s), you may:

- Customize the letter by placing the text on your letterhead.
- Choose the recommended procedure to have the responses sent directly to the Board, and add a statement in the letter to your vendor(s) asking that your vendor(s) send you a copy of their response by fax or mail.

Please note that any changes you make to the sample letter or form must be approved by Board staff before mailing.

The auditor will allow a four week period for you to send the statements and for your vendor(s) to reply. If you have chosen the recommended procedure to have the responses sent directly to the Board, the auditor will timely provide you with copies of the responses received. While the auditor will carefully consider the statements received within the allowed period, late responses may be reviewed and allowed if appropriate.

Please be aware that a statement will not be accepted as satisfactory proof if incomplete, if found to be untrue, or if the Board has or receives information that refutes such statement. An “ABC” response merely acts as one form of evidence of possible tax payment by the vendor and does not preclude further analysis and verification by the auditor.

STATE BOARD OF EQUALIZATION

Sales and Use Tax Department

SAMPLE LETTER
Requesting Vendor's Statement

ABC Company
1234 5th Street
Any Town, CA 90000

Auditors of the California State Board of Equalization are currently examining our records in connection with the California Sales and Use Tax Law. They have questioned certain nontaxed sales made by you, as covered by the invoices listed on the attached sheet.

Since the Board audits both the seller and the purchaser, it is very important that you respond to the enclosed document in order to assure that tax is assessed only once on each transaction.

Would you please review the enclosed document and complete the appropriate portions of it. As noted on the document, you may need to check more than one box for a transaction. The Board will not accept the statement if it is not filled out completely and signed by an authorized representative.

Your prompt response is necessary for us to determine if tax has been paid on this/these transactions. Please return the enclosed document within 10 days using the enclosed envelope or fax to (____) _____.

SAMPLE

**STATEMENT CONCERNING PROPERTY PURCHASED
WITHOUT PAYMENT OF CALIFORNIA USE TAX**

 STATE OF CALIFORNIA
BOARD OF EQUALIZATION

DMA _____

Auditor's Initials _____

Please complete this inquiry statement regarding certain non-taxed sales you made to the customer listed below. Please fill out the form completely, check all the appropriate boxes, and sign as your company's authorized representative. The form should be returned within 10 days.

NAME OF CUSTOMER TO WHOM YOU SOLD ITEMS WITHOUT USE TAX

Invoice Date	Invoice Number	Amount	Description	Response List all boxes (a) through (g) that apply

Please mark all applicable boxes below and list in response area above.

- ☐ a. The tax was paid directly to the Board of Equalization as a result of an audit determination dated _____ covering the period _____ to _____. The Board's audit specifically included the above transaction in the audit assessment.
- ☐ b. The tax was paid directly to the Board of Equalization as a result of an audit determination dated _____ covering the period _____ to _____. The Board's audit examined our sales on a test basis with a percent of error computed and applied. The sales sampled in the audit were similar in nature to the above transaction. Accordingly, as a result of this audit we believe tax on the above transaction has been paid to the Board.
- ☐ c. The Board of Equalization is in the process of auditing our company for the period _____ to _____. The Board is examining our sales to California customers. Accordingly, as a result of this audit we believe that tax on the above transaction(s) may be questioned by the Board.
- ☐ d. I was engaged in business in the special tax district where the sold property was shipped or delivered and tax was or will be assessed as part of an audit by the Board of Equalization. This option should be used in conjunction with Item a, b or c above.
- ☐ e. The property described on the above listed invoices was shipped from the city of _____ in the State of _____.
- ☐ f. No sales or use tax was charged by our company on the above questioned document(s), however, the tax was reported and remitted by our company to the Board of Equalization on our tax return for the period _____.
- ☐ g. Our company has not paid the California sales or use tax to the Board of Equalization and we have not been audited for the same period for the transactions listed above.

COMMENTS

SELLER'S PERMIT NO.

SELLER'S NAME

SIGNATURE

TELEPHONE NO.

TITLE (Owner, Partner, President, etc.)

DATE

The information provided above is subject to verification by the State Board of Equalization.

BT-1032 REV.3 (10-92)

INFORMATION ON OUT-OF-STATE RETAILERS

STATE OF CALIFORNIA

BOARD OF EQUALIZATION

TO: Out-of-State Compliance

Date _____

FROM:

1. Purchaser (or buyer)

Name _____ Account Number _____
street _____
City _____

2. **O/S** Retailer (or vendor)

Name _____ Account Number _____
Street _____
City and State _____

3. Sales Representative

Name _____ Account Number _____
street _____
City and State _____

4. Date of Invoice _____ 5. Invoice Number _____

6. Amount of Purchase _____

7(a). Amount of California Use Tax reported by the purchaser _____

(b). Amount of California Use Tax included in audit of purchaser _____

6. Description of Property Sold _____

9. How Sale was Solicited _____

10. Other Information _____

*Prepare in duplicate
All items should be completed.
(Refer to A.M. Section 0408.22)*

Prepared by _____

BOE-1164 REV. 11 (2-97)

AUDIT MEMORANDUM OF POSSIBLE TAX LIABILITY

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

To _____ -Auditing	FROM _____ - Auditing
<input type="checkbox"/> BUYER'S — FILE	<input type="checkbox"/> SELLER'S — FILE
ACCOUNT NO.	ACCOUNT NO.
NAME	NAME
STREET	STREET
CITY	STATE/ZIP CODE CITY STATE/ZIP CODE
PHONE ()	PHONE ()
PURCHASE ORDER NO.	SHIPPED FROM (if known)

NOTE: Check one **or** more blocks as appropriate and line out **inapplicable** words in parenthesis.

Records of the **(buyer)(seller)** show the following questioned transactions:

- ☐ Tax assessed in audit of **(buyer)(seller)** Period _____ to _____
- ☐ Seller has valid **(resale)(exemption)** certificate from buyer on file. (attach photocopy **of certificate** to BOE-1164)
- ☐ **(Buyer)(Seller)** states that a **(resale)(exemption) (was)(was not)** given.
- ☐ **(Resale)(Exemption)** certificate was issued by the buyer for tools and supplies.
- ☐ **(Sales)(Use)** tax was remitted to seller when paying the indicated ex-tax invoices.
- ☐ Tax (not **added**)(**incorrectly** computed).
- ☐ Other (describe) _____

ATTACH COPIES OF INVOICES OR SCHEDULE ITEMS BELOW

Date	Invoice No.	Amount	Description of Merchandise

☐ See attached invoices **and/or** schedule.

Above Listing covers ☐ Period _____ to _____ . ☐ Sample Listing

COMMENTS AND RECOMMENDATIONS

AUDITOR'S NAME

DATE

Prepare in duplicate and give original to supervisor. Duplicate to be retained with audit. (Refer to A.M. Sections 0401.20 & 0408.20)
Attach BTCIS, RGI, & AUD 1 for receiving district's account

Law Offices of
MOSELEY & LEECH

RALPH J. LEECH
F. CLARKE MOSELEY
D. WAYNE LEECH

11001 EAST VALLEY MALL, SUITE 200
EL MONTE, CALIFORNIA 91731
(626) 443-0061 • (213) 686-2048

Telecopier
(626) 443-1165

E-Mail: cgarcia@myleechlaw.com

FAX TRANSMISSION COVER SHEET

IMPORTANT/CONFIDENTIAL: The information on this facsimile message is attorney privileged and confidential information intended only for the use of the individual or entity named herein. If the reader of this message is not the named addressee, you are hereby notified that any dissemination, distribution, or copying of this communication is strictly prohibited. If you have received this communication in error, please notify us immediately by telephone and return the original message to us at the above address via the U.S. Postal Service. Thank you.

Date: November 15, 1999

No. Of Pages: 3 (including cover)

TO:

FREDA GRENDT-EVANS / LYNN WHITTAKER

Office:

Fax No.:

916 322 4530

FROM:

DOUG BOYD

Fax No.:

626 914 0970

RE:

☐ As you requested

☐ As WC discussed

☐ For your information only

MESSAGE/INSTRUCTIONS

PLEASE DELIVER AS SOON AS POSSIBLE

FAX OPERATOR: CANDY

The Law Offices of
Douglas R. Boyd, Sr.
11001 East Valley Mall, Suite 206
El Monte, CA 91731
Telephone (626) 579-7977
Facsimile (626) 914-0970

Ms. Freda Orendt-Evans
Program Planning Manager
Sales and Use Tax Department
State Board of Equalization
450 N Street MIC:92
Sacramento, CA 95814

November 12, 1999

Dear Ms. Orendt-Evans,

Thank you for this opportunity to comment on California's drop shipment rule. I appreciate the Board's willingness to consider mitigating or eliminating the rule's discriminatory impact on California manufacturers.

I understand you have received a great deal of input on the subject of reforming or eliminating the rule. I will therefore briefly, comment upon the major impacts and be available to provide further information upon request.

The basic problem is that the drop shipment rule provides a disincentive for manufacturers to remain in California or expand their operations in our State. Out of state companies not registered in California have a built in competitive price advantage in an amount equal to our sales or use tax. Out of state companies make sure that potential customers are aware of this price advantage and incorporate it into their sales strategies. It is fundamentally unfair that the sales and use tax structure of California should be used by people who do not live, work, pay taxes or contribute jobs to the economy of our great State as a weapon against those who do. Our system of taxation should help California compete with the rest of the country and the world or at least be strictly neutral.

Adding insult to the injury of paying someone else's sales or use tax is the fact that the measure of the tax is based upon the out of state retailers retail sales price to the end consumer, not the contractual price between the manufacturer and the out of state retailer. Manufacturers therefore are obligated to collect tax on sales they did not make, from people they do not know, at a price they had no role in setting.

Drop shipments are sales for resale. Consistent with the increasingly national and global nature of commerce in the new millenium, the Board and/or the Legislature should take action necessary so resale certificates from other states are recognized by California.

The Board may also wish to consider collecting sales or use tax directly from end customers by giving manufacturers the option of providing the Board with a list of customers. Tax collection is properly a function of the Board and the Board is the only entity with individual taxpayer records. The Board could establish a mechanism for directly billing customers the amount of tax owed based on information provided by manufacturers.

I would welcome the opportunity to participate in a Board effort to help California manufacturers attain a level state tax playing field. Thank you for your consideration.

Cordially,

/s/ Douglas R. Boyd, Sr.

Douglas R. Boyd, Sr.

cc: Honorable Dean Andal
Honorable John Chaing
Honorable Kathleen Connell
Honorable Johan Klehs
Honorable Claude Parrish
Mr. Robert A. Virtue